

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: PRASHANT SARAN, WHOLE TIME MEMBER**

ORDER

DIRECTIONS UNDER SECTIONS 11 and 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH SECTION 12(1B) THEREOF.

1. It has been noticed that the following entities have launched several Unit Linked Insurance Products (ULIPs) :-
 - a. Aegon Religare Life Insurance Company Limited
 - b. Aviva Life Insurance Company India Limited
 - c. Bajaj Allianz Life Insurance Company Limited
 - d. Bharti AXA Life Insurance Company Limited
 - e. Birla Sun Life Insurance Company Limited
 - f. HDFC Standard Life Insurance Company Limited
 - g. ICICI Prudential Life Insurance Company Limited
 - h. ING Vyasa Life Insurance Company Limited
 - i. Kotak Mahindra Old Mutual Life Insurance Limited
 - j. Max New York Life Insurance Co. Limited
 - k. Metlife India Insurance Company Limited
 - l. Reliance Life Insurance Company Limited
 - m. SBI Life Insurance Company Limited
 - n. TATA AIG Life Insurance Company Limited
2. Since, the ULIPs launched by the abovesaid entities were prima facie found to be akin to the mutual fund schemes and were launched without obtaining registration from the Securities and Exchange Board of India (hereinafter referred to as “SEBI”)

under the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as “the SEBI Act”) and the regulations made thereunder, notices were issued to these entities on January 15, 2010 (except in case of HDFC Standard Life Insurance Company Limited where the notice was issued on December 14, 2009). SEBI had sought replies from the said entities as to how the ULIPs were launched without obtaining the requisite certificate of registration from SEBI and why appropriate action should not be taken against them under the provisions of the SEBI Act.

3. The entities replied to the aforementioned notices, *inter alia*, stating that:
 - a. sub-section (2) and (3) of section 11AA of the SEBI Act provide for conditions for any scheme or arrangement to be classified as collective investment schemes and exceptions to the sub-section (2) of section 11AA of the SEBI Act, 1992 respectively.
 - b. section 11AA (3) excludes contracts of insurance under the Insurance Act, 1938 from the purview of collective investment schemes.
 - c. ULIP is a life insurance product and not covered under the definition of “securities” under the Securities Contracts (Regulation) Act, 1956.
 - d. the predominant feature of a ULIP is insurance cover which is dependent on human life and the mere existence of an additional investment feature cannot convert a ULIP into a mutual fund.
 - e. ULIPs have a mandatory insurance cover which forms a vital and inseparable part of every ULIP.
 - f. unlike mutual fund schemes, the linked products are interlinked with the life of the policy holder.
 - g. under a ULIP units are only notionally allocated and not physically issued and the units are created for the purpose of determining the benefits payable under the policy and are not owned by the policyholder.
 - h. under a ULIP only the risk on the investment portion lies with the policyholder while the risk on the life insurance portion vests with the insurer.
 - i. mutual fund units can be transferred or traded freely whereas the rights and benefits under ULIPs are transferable or assignable only for limited purpose.

- j. Unlike a mutual fund, a ULIP is not established in the form of a trust. The fund is held by the insurance company itself as required under the Insurance Act. Ancillary features such as fund management, fund management charges etc., are alone not sufficient to convert a life insurance product into a mutual fund scheme.
 - k. A ULIP is an insurance contract falling within the ambit of life insurance business. “Life Insurance business” is defined under Section 2(11) of the Insurance Act, 1938 inter alia to mean the ‘business of effecting contracts of insurance upon human life’ or ‘the happening of any contingency dependent on human life’. The said definition indicates that the policy is dependent on the happening or the non-happening of an event linked to human life.
 - l. ULIPs fall under the definition of Life Insurance products. Unit Linked Life Insurance Business is defined in IRDA (Investment) Regulations, 2000. Regulation 3(3) states *“every insurer shall invest and at all times keep invested his segregated fund of units linked life insurance business as per pattern of investment offered to and approved by the policy holders....”*
 - m. “Linked business” is defined in IRDA (Registration of Companies) Regulations, 2000 which means *life insurance contracts or health insurance contracts under which benefits are wholly or partly to be determined by reference to the underlying assets or any approved index.*
 - n. the product was launched after following appropriate procedures and obtaining unique identification number from IRDA, which is the regulator in case of life insurance products. Thus, there was no need to obtain requisite certificate of registration from SEBI.
4. Before considering the issues involved in the matter, I refer to the relevant provision of the SEBI Act. Section 12(1B) of the SEBI Act provides as under:

“No person shall sponsor or cause to be sponsored or carry on or caused to be carried on any venture capital funds or collective investment schemes including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations.”

5. I have carefully considered the replies of each of the entities, product brochures of various ULIPs offered by them and the relevant material available on record. Since the subject matter in the notices issued to the entities is identical and their replies are substantially similar, I proceed to deal with issues involved in the matter by way of a common order. Some of the entities have also sought an opportunity of personal hearing. I note that each entity has been served with separate notices and each of them has availed of the opportunity of making its written submissions. Therefore, under facts and circumstances of the case, I do not consider necessary to give an opportunity of personal hearing to the entities in the matter.
6. The question that arises for my consideration is whether ULIPs offered by the said entities are a combination of investment and insurance and if so whether the investment components are in the nature of mutual funds which can only be offered/launched after obtaining registration from SEBI under section 12(1B) of the SEBI Act?
7. From the examination of the product documents of such ULIPs, it is noted that in addition to the insurance component, the ULIPs also have *inter alia* the following characteristics –
- a. the product is unit linked and money is raised from public through sale of units to them.
 - b. the investment risk in chosen investment portfolio is borne by investors.
 - c. upon untimely death before the expiration date of the policy the policy holder will be paid either the NAV (Unitized Fund Value) or the sum assured whichever is higher.
 - d. upon survival at the maturity of the policy, the policy holder will be paid the NAV (Unitized Fund value) of the investments.
 - e. premium will be used to allocate units in the fund chosen by the investor.
 - f. the product has characteristics such as fund management, fund management charges, switch and partial withdrawal options.

8. It is observed that the various ULIPs launched/offered by these entities offer investment options with varying degrees of exposure to equity and debt. It is also noted that in their product brochure for ULIPs, the entities have under the heading “risks of investments”, *inter alia*, disclosed and declared that:
 - a. unit linked life insurance products are different from traditional insurance products and are subject to risk factors.
 - b. the premium paid in unit linked life insurance policies are subject to investment risks associated with capital markets and the unit price of the units may go up or down based on the performance of the fund and factors influencing the capital market and the insured/policyholder is responsible for his/her decisions.
9. From the above, I find that the attributes of the ULIPs launched/offered by these entities are different from the traditional insurance products and they are a combination of insurance and investment. The attributes of the investment component of ULIPs launched by these entities are akin to the characteristics of mutual funds which issue units to the investors and provide exit at net asset value of the underlying portfolio. The investment component of ULIPs is subject to investment risks associated with securities markets which are entirely borne by the investors. I also find that the entities by their own admission have stated that there are two components of ULIPs - an insurance component where the risk on the life insurance portion vests with the insurer and the investment component where the risk lies with the investor. This establishes conclusively that ULIPs are a combination product and the investment component need to be registered with and regulated by SEBI.
10. Now I proceed to deal with the specific contentions raised by the aforesaid entities.
11. Some of the entities have pleaded that the regulations issued by IRDA are special laws for ULIPs and SEBI cannot apply the general laws applicable to tradeable securities such as collective investment schemes or mutual funds to ULIPs. In this regard, I find that in terms of section 11(1) of the SEBI Act one of the duties of SEBI is to protect the interests of the investors in securities and to promote the development

of, and to regulate, the securities market by such measures as it thinks fit. Section 11(2) of the SEBI Act enumerates certain illustrative measures which can be taken by SEBI without prejudice to the provision of sub-section (1). One such measure is registering and regulating the working of collective investment schemes including mutual funds. To carry out the purposes of sections 11 and 12(1B), SEBI has framed various regulations including the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and the Securities and Exchange Board of India (Collective Investment Scheme) Regulations, 1999. The SEBI Act and the regulations made thereunder are also special laws made/laid before the Parliament and any investment product or investment contract having any characteristic of securities or exposing investors to securities market risks is under the jurisdiction of SEBI under the SEBI Act.

12. It is also contended that a mutual fund is a fund established in the form of a trust for raising money through the sale of units through the public and established under one or more schemes for investing in securities. I find that in terms of section 12(1B) of the SEBI Act “no person” can sponsor or cause to be sponsored a collective investment scheme including a mutual fund unless he has been registered with SEBI under the SEBI Act. I note that the emphasis is on the prior registration with SEBI under the SEBI Act, notwithstanding who that person is. Therefore, an entity which is not established in the form of a trust cannot launch or offer an investment product in the nature of mutual fund without being registered with SEBI. The structure of the entity is immaterial for compliance of section 12(1B) of the SEBI Act. For seeking registration such person has to establish a trust for launching mutual fund schemes. Thus, the “trust” structure is not a condition for compliance of section 12(1B) of the SEBI Act though it is a requirement for getting registered as a mutual fund.

13. It is also contended by the said entities that ULIPs are predominantly life insurance products having an investment component. In my opinion, if in a combination product there is an investment component, in any proportion, exposing investors to risks of

securities market products, it can be issued only after obtaining registration from SEBI and compliance of the applicable laws with respect to such component.

14. The entities have contended that the predominant feature of a ULIP is insurance cover which is dependent on human life and the mere existence of an additional investment feature cannot convert a ULIP into a mutual fund. Further, it has been said that ULIPs have a mandatory insurance cover which forms a vital and inseparable part of every ULIP. In this regard I note from one of the products offered by one of the entities that for a sum assured of Rs. 15,00,000/- an annual premium of Rs. 1,50,000/- is collected for 10 years. The premium allocated for insurance out of this is Rs. 7500/- in the first year and Rs. 3000/- in subsequent years. (The annual premium for a term plan for 10 years for an identical sum assured for an identical life assured by the same company is Rs. 3,342/-) Here, the insurance component is 2% of the premium paid. The products offered by other entities also follow a broadly similar pattern. Thus, the argument that insurance is both predominant and inseparable in a ULIP fails.

15. Some of the entities have contended that even if the ULIP is construed to be a mutual fund the existing mutual fund regulations lay down terms and conditions which cannot be complied with by life insurance companies while issuing ULIPs. Further, if SEBI can regulate ULIPs, the SEBI Regulations as they currently stand cannot be applied to the unique features of ULIP and since SEBI has not provided any guidance for insurance companies, they cannot be penalized for any non compliance. I find it unacceptable and untenable that having admitted ULIP as combination product with an investment component, the issuers expect that they be allowed not to comply with the existing Mutual Fund Regulations. The substance and spirit of SEBI Act and regulations framed thereunder makes an over arching emphasis on investor protection. It is imperative and incumbent upon every entity to comply with the regulations. In my view, such products attract the SEBI Regulations and the entities must seek registration from SEBI for launching such products. The existing regulations have detailed scheme and procedure for registration and regulation of

mutual funds. Framing of special regulations for ULIPs under section 12 (1B) is not a pre-requisite for compliance of said section.

16. It is noted that in some of its ULIPs, the entities offer the investors the guarantee to encash the units at maturity at the highest unit price achieved by the fund over the term of the policy. This reinforces that the ULIPs launched/offered by these entities are a combination of insurance and investment. From the examination of the product documents of the ULIPs and the investment options offered therein by the entities it is noted that:

- a. the contributions or payments made by the investor are pooled;
- b. the contributions or payments are made to such ULIPs by the investor with a view to receive profits, income;
- c. the investment made by the investor in the ULIPs is managed on behalf of the investor;
- d. the investor do not have day to day control over the management and operation of the ULIPs.

The aforementioned attributes are those of a collective investment scheme and also of the mutual funds.

17. It is contended that section 11AA (3) of the SEBI Act excludes ‘contracts of insurance’ from the purview of a collective investment scheme as enumerated under section 11AA (2) of the SEBI Act. From the perusal of the product brochures of the ULIPs it is noted that the said products are combination of investment and insurance. The investor chooses between the options and decides as to how much be allocated toward buying insurance and how much be allocated towards investment. The ULIPs have a component of investment product and carry with themselves securities market risk which is borne by the investors. I find that the ULIPs launched/offered by the said entities are not purely in the category of “contracts of insurance” but have components of investment products.

18. It is also contended that the contracts of insurance are exempt from the purview of a collective investment scheme under section 11AA (3) of the SEBI Act. Here, it is necessary to clearly understand the nature of collective investment schemes as referred to in the section 11AA of SEBI Act. Collective investment schemes have characteristics defined in Section 11AA (2); viz. pooled investments, investors not participating in day to day control of investments etc. However, in terms of Section 11AA (3), collective investment schemes exclude all types of schemes/arrangements which have financial bearing, viz. deposits taken by non-banking financial companies, contracts of insurance, pension schemes and also mutual funds. Thus the argument that Section 11AA (3) exempts insurance contracts from the purview of collective investment schemes does not in any way exempt ULIPs which are a combination of insurance and investment from Mutual Fund Regulations.
19. The entities have contended that ULIPs are an insurance contract falling within the ambit of life insurance business and have quoted Section 2(11) of Insurance Act in this regard. It has been established in the preceding paragraphs that ULIPs are a combination of insurance and investment. Therefore, in my opinion, they must be regulated under relevant/applicable Acts and Regulations. The investment component should be registered with and regulated by SEBI.
20. It has been contended that ULIPs are a life insurance product and life insurance products are not covered under Securities Contracts (Regulations) Act, 1956. Units of ULIPS have the characteristics of units of mutual funds. Units of mutual funds are “securities” as defined under Section 2 (h) of Securities Contracts (Regulations) Act, 1956. Merely because they are named as units of ULIPs, such units cannot be ousted from the ambit of definition of “securities”.
21. The entities have also contended that units issued under ULIPs are not freely transferable or have transferability for limited purpose, therefore, they are not units of mutual funds. I find that not all the units of mutual funds are transferable, e.g., in the case of open ended schemes of mutual fund the investor subscribes to and redeems

from the mutual fund directly. The units of an open ended mutual fund scheme are, therefore, not transferable. Further, not in all cases are the units of mutual fund schemes issued physically. I note that it is common among mutual funds to issue statements of accounts. Therefore, the contentions in these regards are misconceived.

22. I find that the attributes of ULIPs launched/offered by the aforesaid entities have components of mutual fund schemes. As discussed above, in spirit and substance, the ULIPs have characteristics of mutual fund schemes and the arguments forwarded by the entities have no merit. It is, therefore, necessary from the point of view of protecting the interest of investors that such products should be offered/launched after obtaining requisite certificate of registration from SEBI under the SEBI Act.

23. The entities have contended that their policies were launched after following appropriate procedures and obtaining requisite permission from IRDA, which is the regulator in case of life insurance products. The approval/registration from one regulatory authority does not exempt the entity from complying with other applicable laws administered by relevant regulators.

24. In view of the above, I conclude that ULIPs offered by the said entities are a combination of investment and insurance and, therefore, the investment components are in the nature of mutual funds which can only be offered/launched after obtaining registration from SEBI under section 12(1B) of the SEBI Act.

25. However, the said entities have not obtained any certificate of registration from SEBI though the ULIPs launched by them had an investment component in the nature of mutual funds, as mandated by section 12(1B) of the SEBI Act. It is, therefore, necessary to restrain the entities mentioned in para 1 of this order from raising further monies/subscriptions, new and/or additional, from the investors for any product (including ULIPs) having an investment component in the nature of mutual funds till they obtain registration from SEBI.

26. Accordingly, in exercise of the powers conferred upon me by virtue of section 19 of the SEBI Act read with sections 11, 11B and 12(1B) thereof, I hereby direct the entities mentioned in para 1 of this order not to issue any offer document, advertisement, brochure soliciting money from investors or raise money from investors by way of new and/or additional subscription for any product (including ULIPs) having an investment component in the nature of mutual funds, till they obtain the requisite certificate of registration from SEBI. This order is without prejudice to any action that might be taken by SEBI in respect of offer documents or advertisements issued by these entities for products (including ULIPs) having an investment component in the nature of mutual funds launched so far.

27. This order will not affect soliciting money/subscription from public with respect to any pure contract of insurance or the insurance component of a combination product.

28. This order shall come into force with immediate effect.

DATE: April 9, 2010

PLACE: MUMBAI

PRASHANT SARAN

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA